



## The UK consumer - winter is coming

The key to our view of weakening UK growth this year was slowing household consumption. With spending having grown a mere 1% annualized in the first two quarters of 2017 versus 3% last year, is the UK consumer over the worst? We don't think so. The risks are also shifting away from a real income shock towards other drivers of demand.

Oliver Harvey  
Macro Strategist  
+44-20-754-51947

### High frequency indicators are showing little sign of improvement

First, it's worth taking the temperature of high frequency indicators. In our last report, we highlighted three areas of spending that explain most of the overall variance in UK household consumption and for which we have high frequency data: transport, household goods and miscellaneous spending.<sup>1</sup>

Car purchases make up 30% of all transport spending, so monthly data on new vehicle registrations do a good job of predicting transport spending. After collapsing to recession levels earlier this year, registrations remain well below long term averages (figure 1). Tax changes were flagged as a factor in April's sharp fall in registrations, but the limited bounce in year on year terms since and downward revisions to corporate sales projections for 2017 [highlighted](#) by Bank of England agents since suggest that weak demand has been just as important.

We use two sources for spending on household goods and services - monthly retail sales volumes and John Lewis sales volumes. Both imply a further slowdown (figures 2 and 3). For miscellaneous spending, the closest proxy we have is Visa spending on miscellaneous items, which has a looser relationship but in contrast shows more resilient demand (figure 4).

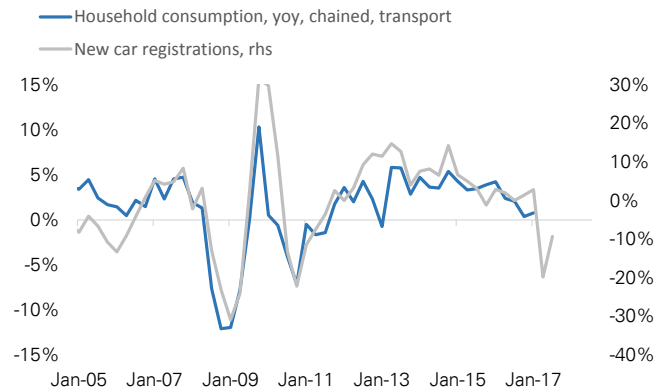
Finally, UK tourist spending has tended to be well correlated to overall consumption, although it only makes up a small amount of overall demand. Monthly data on UK visits overseas track this well. Visits abroad have slowed much less than after the 2008 crisis, despite the weakness in the exchange rate, but are tracking lower. In sum, out of the five high frequency indicators we like to track, four remain weak. A composite indicator of year over year spending suggests a further slowdown in household spending Q3.

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<sup>1</sup> See "Problems in the purse - a deep dive into UK household consumption, May 2017"

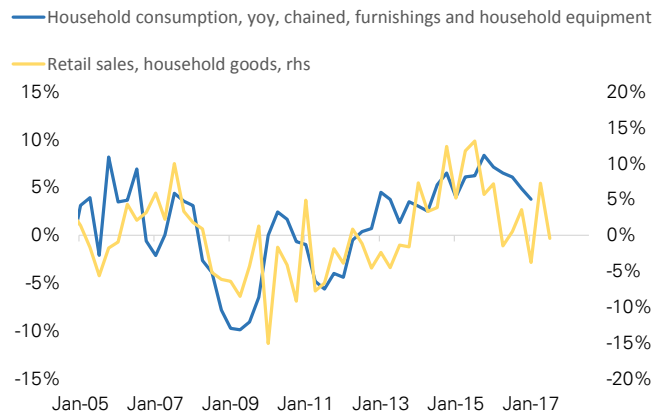


**Figure 1: Limited bounce back in new car registrations after April tax changes**



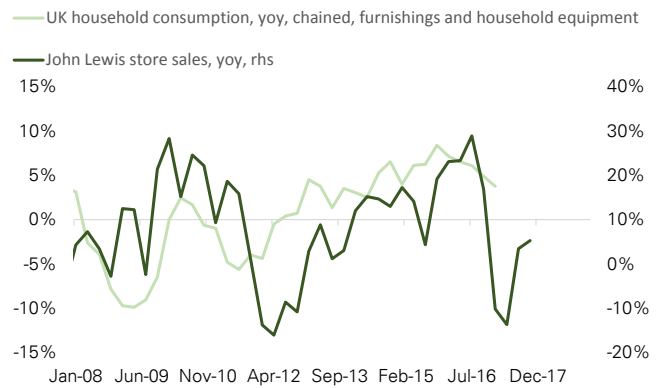
Source: Deutsche Bank, Haver

**Figure 2: Purchases of household goods in retail sales remains weak**



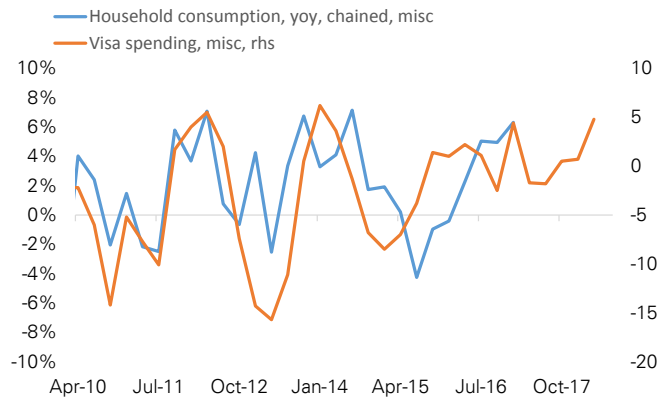
Source: Deutsche Bank, Haver

**Figure 3: Other indicators of big ticket household spending are weak**



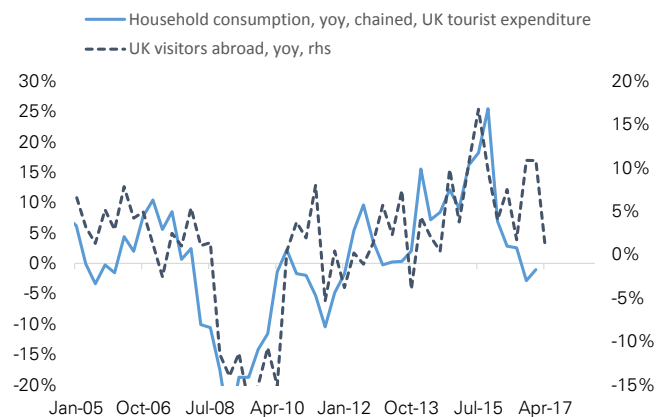
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**Figure 4: Spending on miscellaneous items appears to be more robust**



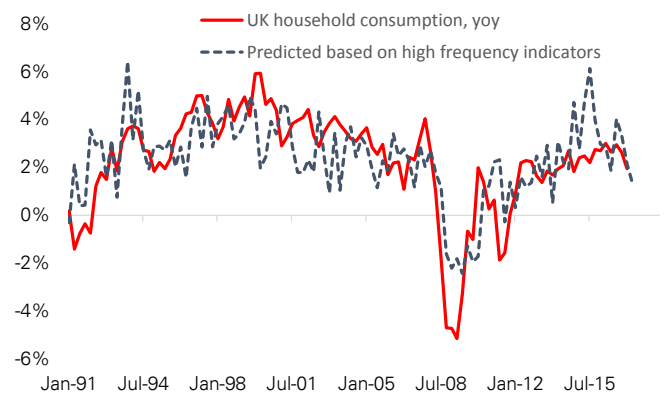
Source: Deutsche Bank, Haver

**Figure 5: UK tourism abroad has slowed, but much less than in 2009**



Source: Deutsche Bank, Haver

**Figure 6: A composite of short-term consumption indicators point to further slowdown in Q3**



Source: Deutsche Bank, Haver



### Medium term risks are shifting from real incomes to employment and savings

What about the medium term? UK household consumption is a function of real income growth, employment growth and spending and savings preferences.

On the income side of the equation, the squeeze on real wages has moderated slightly in the last two months as consumer price inflation has stabilized. Looking ahead, we don't expect real wages to pick up much, however. Headline inflation should increase further to near 3% by year-end and our recent analysis of the labour market suggests Brexit uncertainty is keeping pay settlements in check. We therefore expect real wages to remain around -0.5% yoy for the rest of the year. Meanwhile, the effect of recent sterling depreciation is likely to add to the persistence, if not the peak, of inflation. While we expect nominal wage growth to rise to 2.8% next year, real wage growth is therefore unlikely to get above zero until towards the end of 2018.

Other sources of income may provide a partial offset. Non-labour income was dragged down in the first two quarters of the year by higher taxes paid on dividends and should bounce in the coming quarters. The structural decline in non-labour income is unlikely to reverse soon, however. Interest and dividends have fallen as a result of low interest rates and the declining profitability of UK companies.

On the employment side, risks are rising. Employment growth has remained robust at above 1% yoy in H1, but surveys suggests some cause for concern. On the one hand, some manufacturing industries are reporting labour shortages as they struggle to take advantage of robust global demand and weak sterling. But the real driver of UK employment is services. Here survey data looks weaker. Hiring intentions in the retail sector - one of the dominant sectors in post-crisis UK jobs growth - has collapsed (figure 9). Other services surveys look weak or tepid. We expect a moderate slowing of employment growth in coming quarters to add to the consumer slowdown.

What of household confidence and savings preferences? In our view, a very low savings rate is the main risk for household consumption in the next couple of years. The Bank of England assume that the household savings rate remains unchanged until 2019 (notwithstanding methodological changes that should lead to upward revisions to the level of the savings rate across the last few years). No precautionary build-up in savings is a big assumption in the context of continued Brexit uncertainty. Consumer confidence is now tracking lower, and correlates well with the savings rate over time (figure 11). Consumer credit growth that contributed to falling savings last year has run out of steam, either due to demand or increasing macroprudential attention from the Bank of England (figure 12).

Another risk is house prices. House prices have a good relationship with household consumption. As households have been deleveraging since the financial crisis, the transmission channel is likely to be through boosting confidence rather than leverage. House price growth has already moderated from double digit growth in 2015 to low single digit growth today according to national data, and the best leading indicator of house prices, the RICS house price balance, suggests further declines are in store.

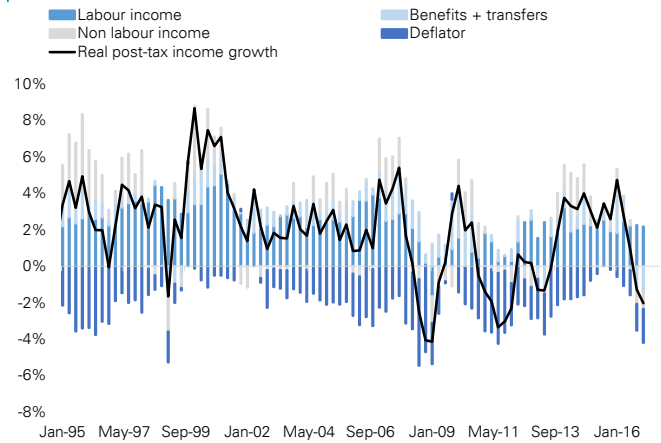


**Figure 7: Real wage growth is unlikely to turn positive until late next year**



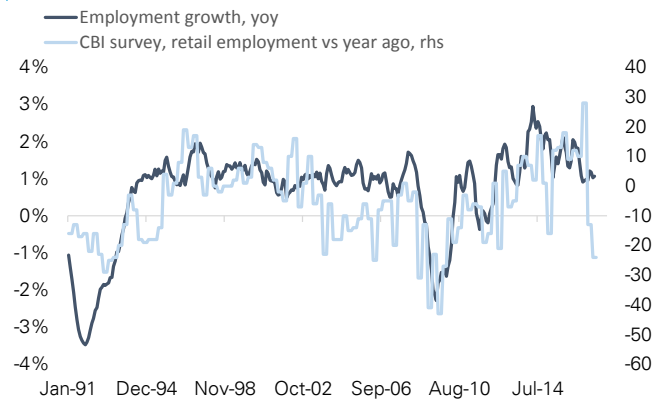
Source: Deutsche Bank, Haver

**Figure 8: Some recent weakness in non-labour income should reverse**



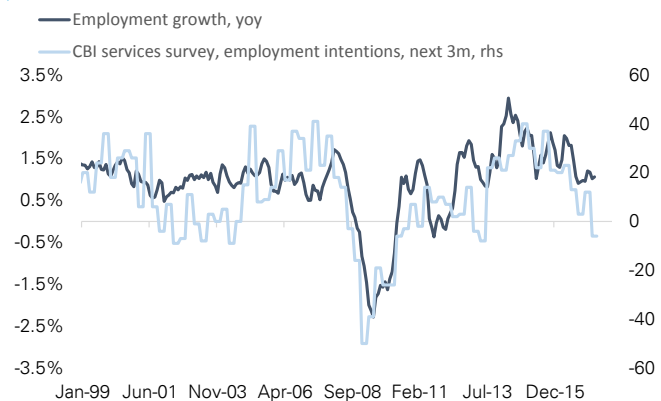
Source: Deutsche Bank, Haver

**Figure 9: Retail employment intentions have collapsed**



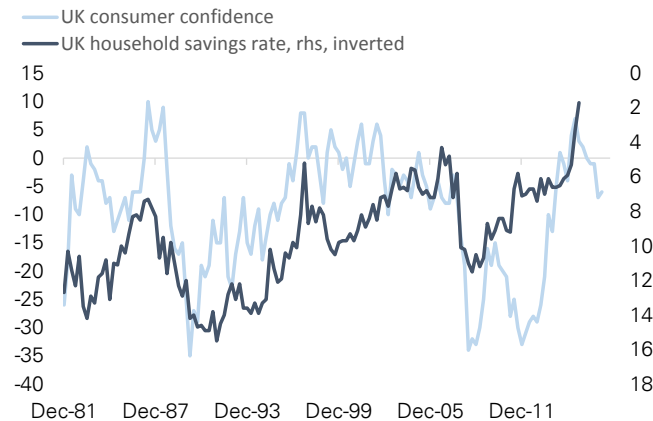
Source: Deutsche Bank, Haver

**Figure 10: Survey indicators of services employment have weakened**



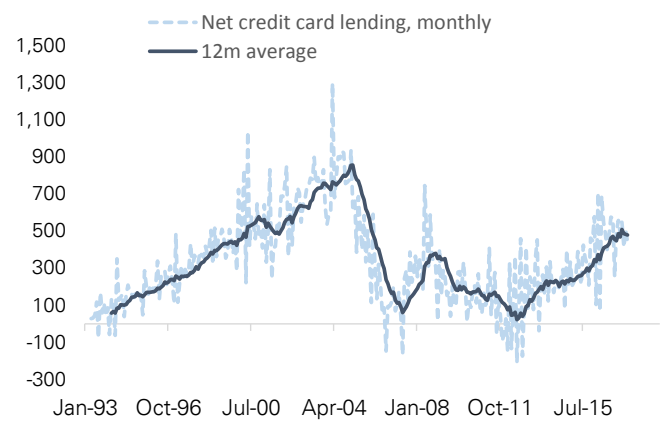
Source: Deutsche Bank, Haver

**Figure 11: Consumer confidence is falling, suggesting the low rate of household savings may reverse**



Source: Deutsche Bank, Haver

**Figure 12: Last year's pick-up in consumer credit appears to have run out of steam**



Source: Deutsche Bank, Haver



In conclusion, the outlook for UK household consumption is worsening, not improving. The further fall in the exchange rate since May will increase the persistence of the inflation pass-through and weigh on real incomes. Surveys suggest downside risks to employment growth in the coming quarters. Consumer confidence continues to weaken, consumer credit growth has slowed and falling house price growth represents another risk. We are downgrading our forecasts for UK household consumption in 2018 from 1.3% to 0.8%, although our 2016 forecast of 1.6% remains unchanged. We expect the worst of the consumer slowdown to be over by the second quarter of 2018.



# Appendix 1

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